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Richard C. Thompson v. The Utah State Tax Commsision : Brief of Appellant

Utah Supreme Court

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IN THE UTAH SUPREME COURT

Richard C. Thompson and Paul C.
Jensen on behalf of themselves and all
other similarly situated taxpayers,

Plaintiffs and Appellants,

vs.

The Utah State Tax Commission, Pam
Hendrickson, R. Bruce Johnson, Palmer
DePaulis, and Marc B. Johnson, as
Commissioners of the Utah State Tax
Commission and the Utah State
Retirement System,

Defendants and Appellees.

Supreme Court No. 20030506-SC

BRIEF OF APPELLANTS

ON APPEAL FROM THE THIRD JUDICIAL DISTRICT COURT
OF SALT LAKE COUNTY, STATE OF UTAH
HONORABLE RONALD E. NEHRING

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Appellants Richard C. Thompson and Paul C. Jensen on behalf of themselves and all other similarly situated taxpayers (collectively “Taxpayers”) through counsel respectfully submit this Appellants’ Brief.

JURISDICTION

This is an appeal from an order of the Honorable Ronald E. Nehring, Third Judicial District Court, dated May 13, 2003, granting Appellees’ Motion to Dismiss for failure to state a claim upon which relief could be granted. This Court has jurisdiction pursuant to Utah Code Ann. § 78-2-2(3)(j) (1953, as amended).

STATEMENT OF THE ISSUE AND STANDARD OF REVIEW

This appeal raises one legal issue: Did the trial court err in concluding as a matter of federal law that the State of Utah did not unlawfully discriminate against federal retirees when it increased pension benefits for selected state retirees for the express purpose of replacing (rebating) a portion of the additional income taxes paid by such state retirees as a result of the repeal of an unlawful and discriminatory tax exemption?

A trial court’s dismissal for failure to state a claim is a question of law and therefore the trial court’s ruling is given no deference and the ruling is reviewed under a correctness standard. *St. Benedict’s Dev. Co. v. St. Benedict’s Hosp.*, 811 P.2d 194, 196 (Utah 1991).

DETERMINATIVE LAW

Davis v. Michigan Department of Treasury, 489 U.S. 803 (1989) is determinative of the issue stated.

STATEMENT OF THE CASE

This case squarely presents an issue of whether form should be exalted over substance. The Utah State Tax Commission and the Utah State Retirement System maintain that the State of Utah can properly do in form (through a selective increase in state retirement benefits) what it admittedly cannot do in substance (discriminate in taxation between federal and state retirees).

As of 1989, twenty-one states exempted retirees who received state retirement benefits from paying state income tax on those benefits, while at the same time levying a state income tax on retirees who received benefits from federal retirement systems. That discriminatory state of affairs ended in 1989 with the United States Supreme Court's decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989). The Supreme Court in *Davis* held that a state tax system which treats federal retirees worse than state retirees violates the constitutional doctrine of intergovernmental tax immunity which is based on the Supremacy Clause.

Some states resisted implementation of *Davis*, and refused refunds for pre-1989 years to federal retirees, claiming that *Davis* did not apply retroactively. The Supreme Court, in a series of decisions ending with *Harper v. Virginia Department of Revenue*,

501 U.S. 1247 (1993), held that *Davis* applied retroactively and the states must provide the federal retirees meaningful backward looking relief removing the discrimination, *e.g.*, a tax refund or a retroactive increase in the tax on state retirees. In response, the Utah Supreme Court ordered tax refunds for federal retirees in *Brumley v. Utah State Tax Commission*, 868 P.2d 796 (1993), *petition for rehearing denied*, 868 P.2d 801 (1993).

The case now before this Court reflects the second chapter of Utah's resistance to the implementation of *Davis* - a legislative effort to provide, in substance, a rebate to certain Utah retirees in a manner that continues to discriminate against federal retirees.

The Utah legislature responded to *Davis*' mandate to eliminate discrimination between federal and state retirees by eliminating the statutory exemption for state retirees but, at the same time, offering an effective rebate to affected state retirees by increasing pension benefits by three percent for the express purpose of offsetting the new state tax liability.

It is indisputable that the Utah legislature increased state pension benefits in direct response to the new tax on state retirement income in an effort partially to alleviate the new tax burden on certain state retirees. The legislature did not even attempt to disguise the rebate. The title of the new legislation was: "Retirement allowance increase to offset tax liability." Moreover, the Tax Commission itself, in November, 1989, characterized the new benefits as a "substantial substitute" for the lost exemption. The increased pension benefits were clearly and indisputably intended to replace the lost tax exemption,

and thus constitute tax rebates to selected state retirees. As noted by the Trial Court, “[i]t is undisputed that the increase in retirement benefits largely offsets the amount of income tax which an individual Utah retiree would be required to pay.” Record of Case No. 010911230 (“Record”) at p.340.

Since federal retirees do not receive these tax rebates, the relative situation of federal and state retirees in Utah remains precisely what it was before *Davis* — federal retirees pay full state income tax on their benefits while state retirees pay less than full state income tax on their benefits because of the rebate.

Richard C. Thompson and Paul C. Jensen, both federal retirees, brought an action on behalf of themselves and all similarly situated taxpayers against the Utah State Tax Commission and its Commissioners in an attempt to remedy the unconstitutionally discriminatory taxation treatment. The Commission and the Commissioners moved to dismiss the complaint, asserting that the complaint failed to state a claim. The Commission and the Commissioners also argued that the Utah State Retirement System should be added as a party defendant to the lawsuit. The Trial court ordered on August 23, 2002 that the Utah State Retirement System be added as a party and allowed to assert its own Motion to Dismiss. Record at pp. 230-232. The Utah State Retirement System was added to the case on August 30, 2002, Record at pp. 233-241 and 265-66, and on October 9, 2002 filed its own Motion to Dismiss, at which time the Commission and the Commissioners renewed their prior Motion to Dismiss. Record at pp. 242-264.

On May 7, 2003 the trial court granted the Utah State Retirement Board's Motion to Dismiss, Record at pp. 346-355, and final judgment against Taxpayers was entered on May 13, 2003. Record at pp. 356-57. Taxpayers filed their notice of appeal on June 3, 2003. Record at pp. 368-370.

STATEMENT OF THE FACTS

1. The United States Supreme Court, in the case of *Davis v. Michigan*, 489 U.S. 803, 109 S.Ct. 1500, 103 L.Ed. 891 (1989), determined that the United States Constitution and 4 U.S.C. §111 permit a state to levy a tax on the retirement benefits paid to retired federal employees only if the retirement benefits paid to retired state employees are treated equally for taxation purposes. Record at p. 5.

2. In Utah, prior to the Supreme Court's ruling in *Davis*, retirement benefits received by employees who had worked for the federal government were subject to the state income tax, but retirement benefits received by employees who participated in the state's retirement system were not. *Id.*

3. The Legislature of the State of Utah responded to the Supreme Court's ruling in *Davis* by revoking the state income tax exemption for retirement benefits received by retired employees under the state's retirement system. *Id.*

4. The Utah Legislature and Utah Courts considered the unlawful tax exemption for state retirement income to be a vested right that was contractually guaranteed. Record at p. 245.

5. Shortly after revoking the exemption, the Legislature, in a 1989 special session held soon after *Davis* was decided, enacted a rebate of somewhat less than one half of the income tax burden imposed on the state retirement income of individuals who were members of the State Retirement System before January 1, 1989. Record at p. 6.

6. The Legislature explicitly stated that its purpose in enacting the rebate was to provide an “increase to offset tax liability,” with direct reference to the tax liability imposed as a result of the *Davis* decision. *Id.*

7. The pension increase was intended as financial assistance for those “retirees who had just seen their state retirement income tax exemption taken away.” Record at p. 246.

8. The Utah State Tax Commission reviewed and evaluated § 49-1-701 after it was enacted and, in November, 1989, issued a bulletin acknowledging that the Legislature enacted §49-1-701 in order “[t]o provide a substantial substitute for the benefit of tax free pensions...” Record at p. 131.

9. The express reason for the rebate was, therefore, to restore the unequal treatment the Supreme Court had ruled unconstitutional in *Davis*. Record at p. 6.

10. This rebate is codified in section 49-1-701 of the Utah Code and is provided by increasing by three percent (3%) the retirement allowance of those members of the Utah State Retirement System whose benefits became taxable as a result of the *Davis* decision. *Id.*

11. The additional pension payment is funded by appropriation of tax dollars to the retirement fund in order to permit the retirement fund to make the additional payments when the affected employees retire. Record at pp. 248-249.

12. The Utah Legislature requires the cost of the additional pension payments to be reported “separately from the costs of the other benefits.” Record at p. 249.

13. The Legislature failed to enact any similar payment or rebate for individuals such as Taxpayers who participate in federal retirement systems and who receive benefits from those systems. Record at p. 6.

14. Taxpayers are individuals who have retired from service for the federal government and reside in the State of Utah. Record at p. 3.

15. Taxpayers paid income taxes to the State of Utah on their retirement benefits from the federal government for the years 1999 through 2000 inclusive. Record at p. 6.

16. Taxpayers overpaid income tax to the State of Utah to the extent of the impermissible tax assessed upon them. Record at p. 7.

17. Taxpayers filed amended tax returns on their own behalf and on behalf of the Class for the years 1999 to and including 2000 pursuant to section 59-10-529 of the Utah Code to obtain refunds of the overpayments they made. *Id.*

18. The Utah State Tax Commission has refused to grant the requested refunds. *Id.*

SUMMARY OF ARGUMENT

Davis v. Michigan Department of Treasury, 489 U.S. 803 (1989), and its progeny established beyond dispute that a tax exemption for state, but not federal, retirement income is discriminatory and unlawful. It is also beyond reasonable dispute that a full or partial rebate of additional taxes paid by state, but not federal, retirees following removal of the unlawful tax exemption is equally discriminatory and unlawful. This is true even if the rebate is disguised as an increase in state retirement benefits. To argue otherwise is to exalt form over substance. A state may not do indirectly what it cannot lawfully do directly.¹ The State of Utah chose to replace a discriminatory tax exemption with an alternate form of payment. The Taxpayers respectfully submit that the State of Utah must be held to a higher standard. By perpetuating discriminatory treatment against federal retirees, Utah remains in violation of the constitutional protections enunciated in *Davis*.

¹ The Supreme Court has emphasized that discrimination that is unlawful in substance cannot be condoned even if it appears proper in form. In *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 (1994), in the context of the Commerce Clause, the Supreme Court struck down a facially even-handed Massachusetts state tax because Massachusetts, by “conjoining a tax and a subsidy,” effectively granted tax rebates to in-state dairy farmers. The Supreme Court noted that its Commerce Clause jurisprudence is not controlled by “the form by which a state erects barriers to commerce; . . . [the Clause] forbids discrimination, whether forthright or ingenious.” *Id.* at 201. The issue in each case is whether the statute, “whatever its name may be, will in practical operation work discrimination against interstate commerce.” *Id.*

Courts in other states have encountered similar challenges to states' creative attempts to evade *Davis*. In each instance in which a state's highest court has directly addressed the issue, the court has refused to allow the state to accomplish indirectly what was constitutionally forbidden if done directly. As succinctly stated by the Oregon Supreme Court in *Vogl v. Department of Revenue*, 960 P.2d 373, 379 (Or. 1998), "in the world of intergovernmental tax immunity, substance does count." The Taxpayers respectfully submit that substance also counts in the State of Utah.²

The State of Utah perpetuated its violation of federal constitutional law when it replaced a discriminatory tax exemption for state retirees with a discriminatory increase in pension benefits to mimic, at least in part, the economic benefits of the illegal tax exemption. The state has, in substance and effect, returned or rebated a substantial portion of the additional taxes paid by state retirees following repeal of the illegal tax exemption, thus perpetuating discrimination against federal retirees. Utah's selective increase in state retirement benefits in response to *Davis*. The trial court erred in

² Reality – and not appearance – governs the determination of a discriminatory taxing scheme. Three years after *Davis*, the United States Supreme Court unanimously struck down a Kansas system that taxed the benefits received from the United States by military retirees but did not tax the benefits received by retired state and local government employees. *Barker v. Kansas*, 503 U.S. 594 (1992). The Court rejected the State's efforts to suggest significant differences between military and state retirees as a basis for the discrimination. The court looked rather to the reality of the state's action, finding that the "state's articulated rationale is not, in fact, the basis for the disparate treatment, but only a cloak for discrimination against federally funded benefits." *Id.* at 604-05.

focusing on the form of the tax rebate rather than the substance, and its order dismissing the Taxpayers' Complaint should be reversed.

ARGUMENT

I. UTAH'S DISCRIMINATORY TAX REBATE SYSTEM VIOLATES THE UNITED STATES SUPREME COURT'S *DAVIS* DECISION

The United States has conditionally consented to state taxation of federal employees. 4 U.S.C. § 111. However, such taxation is permitted only if the state tax system “does not discriminate” against federal “officers and employees” based on the source of the pay. *Id.* Retired federal employees living in Utah brought this action, both individually and as representatives of all others similarly situated, against the Utah State Tax Commission and its individual Commissioners in their official capacities to remedy an unlawful rebate by the State of Utah that discriminates against retired federal employees in favor of retired state employees based on the source of the payment. This rebate violates both the constitutional doctrine of intergovernmental tax immunity and 4 U.S.C. § 111.

Utah, for many years prior to 1989, exempted from state taxation retirement benefits paid by state and local governments. However, the state taxed retirement benefits of federal employees. The Supreme Court in *Davis* held that if a state taxes state and local government retirees differently than it taxes federal retirees, the state violates the United States Constitution as well as 4 U.S.C. § 111. The Supreme Court in *Davis* evaluated a Michigan statutory tax exemption for state and local employees' retirement

benefits that did not apply to federal retirees' retirement benefits. The Supreme Court held that Michigan's taxing regime violated both the United States Constitution and 4 U.S.C. § 111 and struck down Michigan's statutory exemption for retirement benefits paid to participants in state and local retirement systems.

Notwithstanding *Davis*, the Utah Tax Commission refused to grant refunds to federal employees who had paid illegal taxes, arguing that *Davis* did not apply retroactively. The Supreme Court of Utah, however, overruled the Commission in *Brumley v. Utah Tax Commission*, 868 P.2d 796 (1993). The *Brumley* Court ended the first chapter of Utah's resistance to *Davis* by upholding a district court order of refunds to federal retirees.³

This case addresses Utah's second chapter of resistance to *Davis*. The Supreme Court issued a "mandate of equal treatment" to federal and state retirees. *Davis*, 489 U.S. at 818. The Court noted that future discrimination against federal retirees could be ended by either exempting both federal and state retirement benefits from tax or by taxing both:

appellant's claim could be resolved either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees.

³ The court also sustained the district court's denial of the Tax Commission's motion to dismiss based on the taxpayers' alleged failure to exhaust administrative remedies. The Utah Supreme Court found such exhaustion unnecessary because the Commission could not decide the critical legal issues.

Davis, 489 U.S. at 818. The first option, extending the exemption to federal retirees, would have cost the state millions of dollars annually in lost tax revenues. The second option, repealing the exemption enjoyed by state retirees, would have reduced the benefits promised to state retirees. Either option would undoubtedly have been unpopular.

Apparently unhappy with either option permitted under *Davis*, the Utah legislature adopted a third, unsanctioned option. After facially revoking the exemption for state retirement income, it simultaneously increased benefits to state retirees who were members of the retirement system at the time the tax exemption was revoked in an effort to offset the state retirees' new tax liability, in substance granting a partial rebate of the new tax liability (the "Rebate"). The purpose of the Rebate is to compensate current and former state employees who are members of the State Retirement System for the increased tax liability resulting from the elimination of the tax exemption for state retirement benefits. Utah does not grant a similar rebate to federal retirees. Because of the Rebate, state retirees continue, in substance, to enjoy most of the economic benefits of the unlawful tax exemption while federal retirees continue to pay tax as before. Utah has thus effectively retained the discrimination held unconstitutional in *Davis*.

The Rebate is codified in Utah Code Ann. § 49-1-701. This statute expressly links the so-called pension increase to the state retirees' loss of tax exemption on state benefits. Section 49-1-701 is entitled: "Retirement allowance increase to offset tax liability." The

statute provides a three percent increase for those state retirees who had been exempt from tax “but whose allowance has subsequently become subject to that tax.” § 49-1-701. The Utah Tax Commission reviewed and evaluated this statute after it was enacted and, in November, 1989, issued a bulletin acknowledging that the Legislature enacted §49-1-701 in order “[t]o provide a substantial substitute for the benefit of tax free pensions...” There is, therefore, no question that the purported pension increase is, in effect, a tax rebate intended to “substantially substitute” for the state retirees’ loss of their tax exemption. There is also no question that federal retirees do not receive similar treatment.

Utah was not the only state to attempt this type of unsanctioned “third option” to avoid remedying the unlawful discrimination. For example, Montana and Oregon adopted similar approaches and the courts of last resort in both of those states have rejected such schemes as unsuccessful attempts to evade the Supreme Court’s mandate in *Davis*. Indeed, no state court of last resort has reached a contrary result.

The Montana Supreme Court squarely faced and rejected an attempt to evade the *Davis* ruling through a selective pension increase to state retirees in *Sheehy v. Public Employees Retirement Division*, 864 P.2d 762, 768 (Mont. 1993). The Montana Supreme Court found that the Montana legislature violated 4 U.S.C. § 111 when it awarded an “annual retirement adjustment payment” to state retirees at the same time it repealed its

tax exemption for state retirement income. Montana argued that the two provisions were not related. The court found that argument to “def[y] logic.”

[T]he relationship between the tax equalization provisions of the bill, with their negative impacts on state retirees, and the adjustment intended to make up, in part, for that equalization cannot be gain said. The adjustment — while purporting to be an adjustment to state retirement benefits — is, in fact, an adjustment to the equalization achieved via the first sections of Chapter 823. This conclusion is inescapable given the inclusion of the adjustment in, and as part of, the tax equalization program. No other interpretation of these two portions of Chapter 823 comports with our duty to construe statutes in a reasonable manner.

Sheehy, 864 P.2d at 768. The Montana court found the new adjustment was not a “legitimate increase in retirement benefits” but was “intended to make up, in part,” for the new tax liability placed on state retirees. *Id.* at 768. It “is a partial tax rebate denominated otherwise in an attempt to evade the requirements of federal law.” *Id.* In Utah, there is no question that the repeal of the tax rebate and the increased pension benefits are related; the statute expressly so provides.

The Oregon Supreme Court reached a similar result - rejecting a pension increase that was demonstrated, in purpose and effect, to be a discriminatory tax rebate. The Oregon legislature initially elected one of the *Davis*-sanctioned cures to discrimination by repealing the tax exemption for state retirees’ benefits. State retirees in Oregon filed suit and successfully argued that the state had breached its contractual obligation to state retirees by repealing their statutory exemption. Oregon responded to that problem by

increasing pension payments “to compensate for damages suffered by members of [the state retirement system] . . . by reason of subjecting benefits . . . to Oregon personal income taxation.” *Vogl v. Dep’t. of Revenue*, 960 P.2d 373, 380 (Or. 1998). Oregon’s new pension increase was challenged as an illegally discriminatory rebate. The Oregon Supreme Court began its analysis of this question by noting that it had earlier held “both explicitly and implicitly that a tax rebate program aimed solely at state retirement system members would violate *Davis*.” *Id.* at 379. The court concluded that “the benefit increase [under review] is, in substance, a tax rebate.” *Id.* at 381. The new benefit “substantially eliminates the tax on [state retirement system] benefits [by granting the tax rebate], without extending the same favorable tax treatment to federal retirement benefits.” *Id.* at 382. The court found:

The increase purports to give [state retirement system] retirees what they were promised, *viz.*, tax-free retirement benefits. Because the retirees *were taxed*, the increase is the cure. And a cure for being overtaxed is a *rebate*. The increase provided by Oregon Laws 1995, chapter 569, is just that — a rebate. Calling it increased compensation does not change its nature.

Id. at 379-80 (emphasis in original). Because of the discriminatory impact of this rebate, the federal retirees were granted a refund of state income taxes paid. The same is clearly true in Utah. Because members of the Utah State Retirement System faced a new tax by reason of the legislative revocation of their exemption, the “increase to offset tax liability” granted by § 49-1-701 was the cure. Money

provided to offset a tax liability is a rebate. *Davis* cannot be avoided by hiding a discriminatory tax rebate in code sections relating to retirement plans. The Utah Rebate, like those of Montana and Oregon, violates *Davis* and is unlawful.

II. THERE IS NO LITMUS TEST FOR DETERMINING WHETHER AN INCREASE IN BENEFITS PERPETUATES DISCRIMINATORY TAX TREATMENT; ALL RELEVANT FACTORS MUST BE ANALYZED TO DETERMINE LEGISLATIVE INTENT AND ACTUAL EFFECTS

In attempting to distinguish the persuasive authority of *Sheehy* and *Vogl*, the Commission and the Retirement System argued to the trial court, and the trial court erroneously decided, that unlawful discrimination could not be found in the absence of certain specified factors present in those cases. The intent and import of *Sheehy* and *Vogl* cannot be so easily dismissed. In each case, the court examined the statutes at issue and all factors deemed relevant to a determination of legislative intent and substantive effect. In each case, it was determined that the challenged statute was improperly designed to, and effectively did, replace some of the economic benefits of the unlawful tax exemptions with increased retirement benefits.

The *Sheehy* and *Vogl* courts identified several factors relevant to their analyses and their conclusions that the legislatures intended to, and did, replace discriminatory tax exemptions with discriminatory partial tax rebates disguised as increased pension benefits. An analysis of all factors relevant to this case demonstrates the same intent and effect with respect to the “increased benefits” granted by Utah to selected state retirees in

response to *Davis*. The increased pension benefits serve in substance and effect as a partial rebate of the increased taxes stemming from repeal of the unlawful tax exemption.

A. The Montana Supreme Court Examined All Relevant Factors In Order to Determine the Actual Legislative Intent and the Substantive Impacts.

The defendants in this case, and the trial court below, attempted to distinguish *Sheehy* on the ground that the increased pension benefits in that case were granted only to Montana residents and were funded by direct appropriations from the general fund. *Sheehy*'s import cannot properly be ignored on such a superficial basis. The *Sheehy* court examined all factors that it considered relevant to determine the actual import and intent of the challenged statute.⁴ The court was concerned with the legislature's true intent, as opposed to the appearance the legislature attempted to create.

The Montana Supreme Court found that the title and the content of the legislation confirmed that the purported increase in retirement benefits was, in substance, partial

⁴ Among the factors analyzed by the *Sheehy* Court were the following: (i) the increase in pension benefits was clearly related to, and enacted in response to and partial replacement of, the discriminatory tax exemption; (ii) the increased benefits were not extended to all retirees, but only to those living in Montana; and (iii) the increased benefits were funded through appropriations from the general fund, in a different manner than other retirement benefits. An examination of similar factors in this case confirms the same conclusion - the increased Utah pension benefits were intended as a partial rebate of additional taxes incurred due to the lost tax exemption. The Utah Rebate is: (1) undeniably related to, and enacted in direct response to and in partial replacement of, the discriminatory tax exemption; (2) not extended to all retirees, but only to those who once enjoyed, and subsequently lost, the unlawful tax exemption; (3) indirectly funded from the general fund; and (4) calculated, adjusted and reported separately from all other pension contributions and payments.

compensation for, or a partial “rebate” of, the additional taxes paid by state retirees as a result of the loss of the unlawful tax exemption. The Court also found that the legislation lacked certain attributes of a legitimate general increase in retirement benefits. According to the Montana Supreme Court, these factors demonstrated that “the adjustment is a partial tax rebate denominated otherwise in an attempt to evade the requirements of federal law.” 864 P.2d at 768.

B. The Oregon Supreme Court Also Examined All Relevant Factors to Determine Actual Intent and Effects.

The defendants and trial court in this case attempted to distinguish *Vogl* because the Oregon Supreme Court noted the close correlation in that case between the amount of the pension increase and the lost exemption, a reading that misapprehends and misapplies Oregon case law. Two Oregon Supreme Court cases clearly demonstrate that court’s recognition of the need for a careful examination of all relevant factors in order to determine whether a challenged pension increase is in substance an unlawful tax rebate.

In *Ragsdale v. Department of Revenue*, 895 P.2d 1348 (Ore. 1995), the Oregon Supreme Court analyzed a number of factors in an effort to determine whether the increased pension benefits at issue in that case were, in effect, discriminatory tax rebates. After reviewing the available information, the court concluded that the plaintiffs had not sufficiently demonstrated that the pension increases were intended to, or in effect did, act

as a substitute for the illegal tax rebate.⁵ A few years later, in *Vogl v. Dep't. of Revenue*, 960 P.2d 373, 380 (Or. 1998), by contrast, a similar analysis of all relevant factors led the same court to conclude that the challenged pension increase in that case was in fact discriminatory and unlawful.⁶ In each case, the Oregon Supreme Court undertook an

⁵ The *Ragsdale* court focused primarily on the following factors: (1) the pension increase was not shown to be part of the State's system of taxation; (2) there was no correlation, directly or indirectly, between state tax liability and increased retirement benefits; (3) the increased benefits were funded by the retirement trust fund and not the general fund; and (4) the increase in benefits was provided to all state retirees, based on years of service. The Oregon court acknowledged that certain aspects of the challenged legislation suggested an illegal tax rebate but concluded, on balance, that the benefits had not been shown to be discriminatory. Here, by contrast, the pension increase is clearly and expressly part of Utah's tax code. Moreover, although there is no direct correlation to Utah tax rates, an indirect correlation exists in that the selective increase in benefits is payable only to those who once enjoyed the benefits of the unlawful tax exemption. Finally, the Utah Rebate is indirectly funded by the general fund, and is reported, analyzed and funded in a manner separate and distinct from legitimate pension benefits.

⁶ The primary factors considered by the Court in *Vogl* included: (i) the increased benefits were tied directly into Oregon's income tax statutes; (ii) the increase applied only to income attributable to service prior to repeal of the unlawful tax exemption; (iii) retirees had no contractual right to the increased benefits; (iv) the benefits were intended as partial compensation for damages suffered by state retirees as a result of the repeal of the unlawful tax exemption. In addition, the court noted that the Oregon statute required that the increase be reported separately from other pension benefits. An analysis of similar factors in this case leads to the same conclusion for the Utah statute: (1) The Rebate is clearly part of Utah's taxation statutes; (2) the Rebate is selectively available only to those state retirees who once enjoyed the illegal tax exemption; (3) while the Board and Tax Commission admit that the Rebate is a vested contractual right, the Utah statute does not create contractual rights for all retirees, but only for certain retirees; (4) the Utah Rebate was clearly and admittedly intended as compensation for a portion of the damages suffered by state retirees as a result of the repeal of the tax exemption; and (5) Utah statutes require special and unique reporting requirements for the Rebate and prohibit inclusion of the Rebate in comparative studies.

analysis of all relevant circumstances surrounding the increase in order to glean actual legislative intent and actual impacts of the purported increase.

Among the various factors examined in *Vogl* was that the increased pension benefits were calculated in a manner that closely correlated with the lost tax exemption. This factor was cited by the trial court below in distinguishing *Vogl*. However, the relevance of this factor was misapprehended by the trial court. The importance of the way in which the increased benefits were calculated in *Vogl* was what it communicated about the legislature's intent in enacting the increase. The *Vogl* court looked at the correlation between the increased benefits and the tax rate as a strong indication of the legislature's intent to return (or rebate) a portion of the additional taxes caused by the loss of the tax exemption. The *Vogl* court confirmed the proper relevance of this factor by noting, "as the state moves closer to replacing lost net income on a dollar for dollar basis, the fact that the increase is in fact a tax rebate ... becomes more apparent." 960 P.2d at 380.

The *Vogl* court correctly observed that the more closely the legislature attempts to replace the exact amount of lost income the easier it is to discern the legislature's true intent. However, the court did not suggest that failure to fully rebate the new tax would have made the pension increase lawful. In fact, neither the 1995 statute at issue in *Vogl* nor the 1991 statute at issue in *Ragsdale* replaced dollar for dollar the amount of money state retirees lost as a result of the repeal of the exemption. The correlation of the rebate

and the tax, along with all other factors considered by the court, demonstrated the true intent and import of the increased benefits. The *Vogl* court's analysis was clearly designed to determine what the legislature actually intended, not to establish a litmus test as erroneously assumed by the trial court.⁷

In summary, state supreme courts that have analyzed increased pension benefits granted in response to *Davis* have concerned themselves with determining the true substance and intent of the legislation, as opposed to the form. They analyzed all factors deemed relevant to that determination; they did not lay out bright line tests. A similar analysis of relevant factors in this case compels the conclusion that the Utah statute, like the Montana statute and the 1995 Oregon statute, was intended to replace (or rebate) a portion of the new taxes imposed on state retirees through repeal of the discriminatory tax exemption. As cogently explained by the *Vogl* court, compensation designed to replace a lost tax exemption is a tax rebate, no matter what you call it:

“The increase purports to give ... retirees what they were promised, viz, tax-free retirement benefits. Because the retirees were taxed, the increase [in pension benefits] is the cure. And a cure for being overtaxed is a rebate. ... Calling it increased compensation does not change its nature.” 960 P.2d at 381.

⁷ A primary reason that the *Vogl* court focused attention on the way the pension increase was calculated was to distinguish *Ragsdale*. Most of the factors analyzed in *Ragsdale* were also present in *Vogl*. One of the major distinguishing factors was the absence in *Ragsdale* of any “direct or indirect” correlation between state tax obligations and increased retirement benefits. *Ragsdale*, 895 P.2d at 1354. In *Vogl*, the court found this missing correlation, in part because of the manner in which the pension increase was calculated.

III. THE FACTORS RELEVANT TO THIS CASE CONFIRM THAT THE UTAH LEGISLATURE INTENDED TO PARTIALLY REBATE THE ADDITIONAL TAXES PAID BY CERTAIN STATE RETIREES AS A RESULT OF THE REPEAL OF THE UNLAWFUL TAX EXEMPTION.

The Utah Legislature admittedly intended to, and did, enact legislation to replace or rebate a portion of the additional taxes paid by those state retirees who had lost the benefit of the unlawful tax exemption as a result of *Davis*. A summary of relevant factors (identified and supported in the Statement of the Facts, above, and explained in more detail below) that demonstrate this undeniable intent and effect is as follows:

- The Legislature considered the tax exemption as a vested right for those who were members of the system prior to January 1, 1989, that could not be removed without providing a substantial substitute for that benefit;
- The Legislature deprived the pre-1989 members of their vested rights by repealing the tax exemption, thus increasing the taxes they must pay;
- The Legislature attempted to provide a substantial replacement for the vested right that had been lost by increasing payments to pre-1989 members to offset (or partially rebate) the increased taxes;
- The payments authorized by the Legislature were not made to all members of the retirement system, but only to those who experienced an increase in taxes as a result of the repealed exemption;
- the Legislature explicitly acknowledged that the increased payment was intended to offset, in part, the increased taxes that pre-1989 members were

required to pay; and

- The increased benefits designed to offset increased taxes are funded, reported and analyzed separately from all other pension benefits.
- A. The Increase in Utah's Pension Benefits was Enacted to Compensate Certain State Retirees for the Loss of Vested Rights.

The Utah Legislature and Utah Courts considered the unlawful tax exemption for state retirement income to be a vested right that was contractually guaranteed. When the Legislature breached its contract with certain members of the state Retirement System by repealing the tax exemption (as opposed to honoring that obligation and extending the discriminatory tax exemption to federal retirees), it attempted to remedy its breach by making additional payments to offset the increased taxes paid by certain state retirees. The statute is thus entitled a “[r]etirement allowance increase to offset tax liability,” and the state Tax Commission confirmed that the increase was enacted in order “[t]o provide a substantial substitute for the benefit of tax free pensions....” [UTAH TAX COMMISSION BULLETIN issued November 11, 1989] The increase was thus clearly intended as partial compensation for the State’s breach of contract.⁸ The pension increase was intended as financial assistance for those retirees who had just seen their state retirement income tax

⁸ Significantly, the state did not fully remedy its admitted breach of contract, leaving state retirees only partially compensated for the damages they have suffered. An appropriate proceeding to recover those damages will presumably be pursued in a separate case.

exemption taken away. This is equivalent to the Oregon legislature's intent in *Vogl* that the pension increase compensate for similar damages.

B. The Increased Pension Benefits are Directly Correlated With State Retirees' Individual Income Tax Obligations.

The payment at issue here is directly correlated with state retirees' income tax obligations. Although the amount of the increase is not calculated with reference to state income tax rates as was done in *Vogl*, the additional payment was targeted only to those members of the state retirement system who had enjoyed, but then lost, the benefits of the unlawful tax exemption, and who had suffered an increase in state income taxes as a result. Other members were never entitled to the tax exemption and thus did not experience an increase in taxes as a result of the repeal. Those retirees do not receive the extra payment. The payment is thus directly related to state retirees' state income tax obligations.

C. The Legislature Intended the Increased Benefits as a Rebate of a Portion of the Increased Taxes Resulting From Repeal of the Tax Exemption.

The Legislature explicitly acknowledged that the purpose of the payment was to reduce the taxes paid by state retirees who lost the promised exemption. The payment, according to the Legislature, is made for the express purpose of "offsetting [an increased] tax liability." The Legislature's intent is clear. The payment is designed to rebate a portion of the additional taxes that state retirees were required to pay as a result of losing their discriminatory, but vested, tax exemption.

D. The Increased Pension Benefits are Funded From General Tax Revenues and are Reported and Analyzed Separately from All Other Pension Benefits.

The additional pension payment is funded by appropriation of tax dollars to the retirement fund in order to permit the retirement fund to make the additional payments when the affected employees retire. Thus, the payment is paid to the retirement fund which has a statutory duty to ensure that the money is preserved for the purpose of making additional payments to eligible retirees. The additional payment promised by the Legislature to reduce state retirees' tax burden is funded with state tax dollars.

Other aspects of the purported pension increase also confirm that the Legislature did not intend this additional payment as a legitimate increase in pension benefits. The cost of the additional payments must be reported separately from the costs of all other benefits. If this additional payment were simply a general or legitimate increase in benefits, the increase would be reported and analyzed as part of all pension benefits.

Similarly, the legislative prohibition against including the Rebate in comparative studies of public employment benefits shows that the increased payments to selective state retirees are not simply increased pension benefits. Tellingly, the Board acknowledged to the trial court that, if the Rebate were included in such comparisons, it would "artificially inflate the value of the employees' compensation." [Record at p. 249] Comparisons of retirement compensation can be "artificially inflated" only if the Rebate

is not a legitimate increase in pension benefits. A legitimate increase in benefits would not reflect artificial inflation.⁹

An analysis of all relevant factors compels the conclusion that the Utah Legislature intended to, and effectively did, authorize a partial rebate of the increased tax liability suffered by certain state retirees following revocation of the discriminatory tax exemption. The discriminatory tax rebate cannot stand.

IV. THE UNITED STATES SUPREME COURT'S DECISION IN *DAVIS* DOES NOT CONDONE STATE PERPETUATION OF DISCRIMINATION AGAINST FEDERAL EMPLOYEES IN A DIFFERENT FORM.

The defendants argued below, and the trial court in this case (as well as a trial court in another state¹⁰) concluded, that the *Davis* opinion somehow condones form over substance in analyzing state responses to unlawful discrimination against federal retirees. Such a startling conclusion is not supported by logic or by the *Davis* opinion.

The *Davis* opinion identifies only two ways that a state can eliminate the illegal tax discrimination: exempt both federal and state retirement benefits from tax, or tax

⁹ The defendants point out that the legislative restrictions on reporting and comparative studies were added in subsequent legislative sessions. It is not relevant whether the restrictions were included in the initial legislation or added subsequently. The original legislation is explicit in expressing legislative intent that the Rebate was intended to return a portion of the taxes that would be incurred by some retirees following repeal of the discriminatory tax exemption. The subsequent legislation simply confirms this intent by insisting that the Rebate be reported and analyzed separately from all other pension payments.

¹⁰ *Almeter v. Virginia Department of Taxation*, 53 Va. Cir. 429, 2000 WL 1687589 (Va. Cir. Ct. 2000).

both. *Davis*, 489 U.S. at 818. The defendants, however, attempt to twist arguments contained in a dissenting opinion, combined with responsive dicta in a footnote in the majority opinion, into a Supreme Court sanction for states to perpetuate unlawful discrimination against federal employees by simply disguising it in the form of a benefit increase, or by avoiding any adverse impacts on the federal treasury.¹¹ Such an argument flies in the face of the Court's reasoning in *Davis*, exalts form over substance, and is inconsistent with established Supreme Court law. *E.g.*, *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 (1994); *Barker v. Kansas*, 503 U.S. 594 (1992). The substance - not the form - of the legislative action is controlling, and the impact on the federal treasury is irrelevant to the issue of unlawful discrimination.

The tendency illustrated by the defendants in this case to grasp for illogical answers to *Davis* is perhaps understandable given the indisputable fact that a state has the right to set (and increase) pension benefits for state employees. If the State of Utah were

¹¹ A dissenting opinion by Justice Stevens in *Davis* asserts that a state “may always compensate in pay or salary for what it assesses in taxes” and “has an unquestionable right to provide ... increased retirement benefits.” 489 U.S. at 824 (citation and footnote omitted). Without challenging (or accepting) Justice Stevens' assertions, the majority opinion includes a footnote in response to the dissent in order to illustrate one of the perceived pernicious impacts of the specific discriminatory statute at issue in that case, i.e., adverse economic impacts on the federal treasury. 489 U.S. at 815 n. 4. It takes an astonishing leap of logic to conclude that this footnote dicta condones a state disguising a discriminatory and unlawful tax exemption in another form, or discriminating against federal employees so long as there is no adverse impact on the federal treasury. Neither conclusion can withstand logical scrutiny or the clear import of the majority opinion in *Davis*.

to elect to increase pension benefits for state employees for legitimate, non-discriminatory reasons, federal retirees would have no complaint and would not demand similar payments. That, however, is not the case here. It is simply not useful in this case to engage in a debate over whether a different conclusion might be reached if the intent and effect of the Utah Rebate had been better disguised. Here, the intent and effect are clear and indisputable. The discriminatory impact of the unlawful tax exemption was intentionally perpetuated by the State of Utah and must be eliminated.

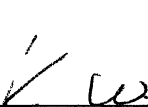

CONCLUSION

The express intent and actual effect of the Utah Legislature in adopting Utah Code Ann. § 49-1-701 was to return to state retirees a portion of the new taxes they incurred by virtue of the repeal of an unlawful tax exemption. A facial review of the statute, and particularly when considered in the context of all relevant circumstances, compels the conclusion that the State of Utah has granted a discriminatory tax rebate of a substantial portion of the increased taxes resulting from the repeal of the discriminatory tax exemption outlawed by *Davis*. A discriminatory tax rebate is no more lawful than a discriminatory tax exemption. Substance prevails over form. Federal retirees are entitled to relief.

For all of the reasons set forth above, the trial court erred in finding that the Taxpayers did not state a claim for relief and in dismissing the Taxpayers' Complaint. The court's ruling granting Appellees' Motion to Dismiss should be reversed.

RESPECTFULLY SUBMITTED this 27th day of August, 2003.

HATCH, JAMES & DODGE

By:  
Gary A. Dodge
Kevin W. Bates

Attorneys for Appellants

CERTIFICATE OF SERVICE

I certify that I caused a true and correct copy of the foregoing BRIEF OF APPELLANTS to be placed in the United States Mail first class postage pre-paid on the 22nd day of August, 2003 addressed to the following:

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ADDENDA

CONSITING OF

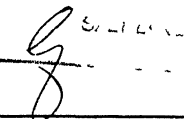
- Addendum “A” Minute Entry, Third Judicial District Court, Case No.
010911230, entered on April, 4, 2003.
- Addendum “B” Order of Dismissal, Third Judicial District Court, Case No.
010911230, entered on May 13, 2003.

ADDENDUM “A”

APR 24 '93

THIRD DISTRICT COURT, STATE OF UTAH
SALT LAKE COUNTY, SALT LAKE DEPARTMENT

By



RICHARD C. THOMPSON et. al.,

Plaintiffs,

vs.

UTAH STATE TAX COMMISSION, et.
al.,

Defendants.

MINUTE ENTRY

CASE NO. 010911230

JUDGE RONALD E. NEHRING

This matter is before me on defendants' Motion to Dismiss the plaintiffs' complaint. For the reasons stated below, I grant defendants' motion.

On September 19, 1989, the Utah legislature made state retirement income as well as federal retirement income taxable, while at the same time increasing pension benefits to state retirees by 3%. Utah Code Ann. § 49-1-701 (1998). Plaintiffs, retirees who were employed by the federal government, challenge the state's decision to increase pension benefits to state retirees, claiming that the benefits are merely a replacement for the lost tax exemption and essentially constitute tax rebates to State retirees.

A full understanding of the nature of plaintiffs' claims requires a historical explanation. Prior to 1989, 21 state exempted recipients of state retirement benefits from income tax while imposing income tax on the benefits of federal retirees. In 1989, the United States Supreme Court ended this practice, finding

that it constituted unlawful tax discrimination in violation of federal law and the doctrine of intergovernmental tax immunity. Davis v Michigan, 489 U.S. 803 (1989).

Utah, like many sister states, responded to the Supreme Court's edict by amending its statute to make state retirement benefits taxable. The legislature also increased pension benefits to state retirees by 3%. Utah Code Ann. § 49-1-701 (1998). It is undisputed that the increase in retirement benefits largely offsets the amount of income tax which an individual Utah retiree would be required to pay.

Plaintiffs contend that Utah's response to the mandate of Davis was nothing more than a sham that merely perpetuated the unlawful discrimination which existed pre-Davis where federal retirees pay full state income tax on their benefits while state retirees pay less than full state income tax on their benefits because of the rebate.

I have reviewed the reported cases addressing similar challenges to legislative responses to Davis. See, Sheehy v Association of Montana Retired Public Employees, 864 P.2d 786 (Mont. 1993), Ragsdale v Department of Revenue, 895 P.2d 1348 (1995), Vogl v Department of Revenue, 960 P.2d 373 (Or. 1997), Almeter v Virginia Department of Taxation, 53 Va. Cir. 429 (2000) cert denied. Irrespective of outcome, these cases recognize that

the Davis court did not foreclose, and in fact anticipated, a state's ability to respond to the court's holding by increasing benefits to its retirees. Those cases which invalidated, as violative of Davis, increases in state retiree benefits, did so only because the benefit increases incorporated additional provisions which made transparent the true and improper nature of the response----creating a tax rebate.

Specifically, in Sheehy the Montana Supreme Court concluded that Montana's response to Davis was actually a discriminatory partial tax rebate that improperly favored state retirees "living in Montana based solely on the source of their retirement income." 864 P.2d 762, 768 (1993). Further evidence of a tax rebate was the fact that Montana's funding for the adjustment was statutorily appropriated from the general fund and not funded by investment income produced by the retirement fund itself. Id. at 768.

Similarly, in Vogl it was determined that Oregon's 1995 statutory increase to the Public Employees Retirement System ("PERS") benefits to compensate for "injuries" arising out of the taxation of the PERS benefits was in violation of Davis. 960 P.2d 373 (1997). The Vogl Court ultimately concluded that the increase in PERS benefits was a tax rebate because the relationship between the lost exemption and the 1995 increase was one of "purported legal equivalence." Id. at 381.

Upon consideration of these cases, I conclude that Utah's statutory response to Davis is untainted by any of the above mentioned provisions from which one could reasonably conclude that the benefit increase was, in fact, a tax rebate.

It would be disingenuous for me to suggest that the timing and content of the amendments to Utah Code Ann., Section 49-1-701 (1998), did not reflect our legislature's desire to accomplish by lawful means the result which the Davis court found to be impermissibly discriminatory. The timing and intent of the legislature's response to Davis is not, however, controlling. Of primary importance is the plain language of the statutory product of the legislature's response to Davis. The statute itself applies to all members whose retirement allowance was previously exempt from tax, pre-Davis, but whose allowance has "subsequently become subject to that tax." Specifically, a member shall receive:

- (a) the administrator shall calculate the member's retirement allowance pursuant to the formula governing the system from which the member retired;
- (b) the administrator shall then increase the allowance calculated under Subsection (2)(a) by 3%; and;
- (c) the adjusted retirement allowance under Subsection (2)(b) is the new basis upon which any future adjustments to benefits are made

UCA § 49-11-701 (2002)¹.

Additionally, under subsection (6),

¹The 2002 amendment, effective March 27, 2002, renumbered this section, formerly referred to as § 49-1-701.

- (a) [t]he retirement board shall annually certify the contribution rate necessary for each system to comply with this section and may adopt rules to administer this section.
- (b) [t]his contribution rate shall be reported separately from the total contribution rate necessary to fund the systems on an actuarially sound basis and may not be used in comparative studies of public employee benefits.

UCA § 49-11-701 (2002).

A close look at these statutory provisions indicates that the language betrays no discriminatory content. First, the 3% adjustment is given to all retirees who were members of the system. There is no distinction between retirees located in the state of Utah and those located out of state. Essentially, every eligible retiree who retired on or after January 1, 1989 received the 3% increase. UCA § 49-1-701(1)(3)(1998). Second, the statute itself evidences no attempt to coordinate the 3% benefit with the income tax rates or structure as found under Utah Code Ann, Title 59. Finally, distinguishing itself from Sheehy, the plain language shows that the legislature does not fund the 3% adjustment via direct legislative appropriation of tax dollars to eligible retirees. UCA § 49-1-701(6). Ultimately, the total cost is recognized as a direct part of the total employees' compensation package.

This statutory analysis, coupled with the Davis court's clear anticipation of the Utah legislature's response, through its

holding, warrants the conclusion that plaintiffs' claim must fail as a matter of law and defendant's motion is hereby granted.

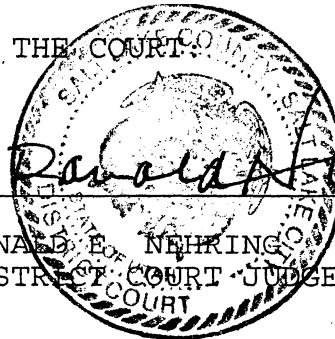
In view of the foregoing, I need not reach the other arguments advance by defendant in aid of its motion.

Defendant's counsel shall prepare an Order consistent with this Minute Entry.

Dated this 23 day of April, 2003.

BY THE COURT

RONALD E. NEHRING
DISTRICT COURT JUDGE



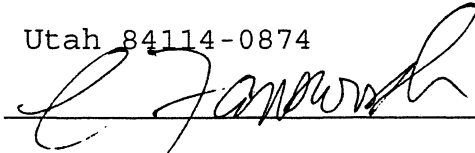
MAILING CERTIFICATE

I hereby certify that I mailed a true and correct copy of the foregoing Minute Entry, to the following, this 24 Day of April, 2003:

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ADDENDUM “B”

MAY 13 2003

SALT LAKE COUNTY

Deputy Clerk

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THIRD DISTRICT COURT, STATE OF UTAH
SALT LAKE COUNTY, SALT LAKE DEPARTMENT

RICHARD C. THOMPSON et. al.,)	
)	ORDER OF DISMISSAL
Plaintiffs,)	
)	
vs.)	Case No. 010911230
)	
UTAH STATE TAX COMMISSION,)	
et. al.,)	Judge Ronald E. Nehring
)	
Defendants.)	

This matter came before the Court for oral argument on August 20, 2002, pursuant to the Motion to Dismiss of the Utah State Tax Commission Defendants. On August 23, 2002, the Court entered an Order joining the State Retirement Board. Subsequent to that order, Plaintiffs, Tax Commission Defendants, and the State Retirement Board agreed on a schedule and filed memoranda to supplement the Motion to Dismiss that was heard on August 23,

2002. Plaintiffs were represented by Gary Dodge, Kevin W. Bates, and Mark R. Clements of the law firm of Hatch, James and Dodge. The Tax Commission was represented by John C. McCarrey and Timothy A. Bodily, Assistant Attorneys General. The Utah State Retirement Board was represented by Kevin A. Howard, Gregory D. Phillips, Daniel D. Andersen, and David B. Hansen of the law firm Howard, Phillips and Andersen.

The State Retirement Board joined in the pending Motion to Dismiss. After reviewing the supplemental pleadings, the Court concluded that the oral argument held on August 20, 2002, was sufficient and that further oral argument would not aid the Court in its decision.

Having reviewed the pleadings of the parties submitted prior to the hearing, and having reviewed the subsequent pleadings filed by Plaintiffs, the Tax Commission Defendants, and the Utah State Retirement Board, this case is dismissed pursuant to Rule 12(B)(6) of the Utah Rules of Civil Procedure. For the reasons stated below, I grant Defendants' motion.

On September 19, 1989, the Utah legislature made state retirement income as well as federal retirement income taxable, while at the same time increasing pension benefits to state

retirees by 3%. Utah Code Ann. § 49-1-701 (1998). Plaintiffs, retirees who were employed by the federal government, challenge the state's decision to increase pension benefits to state retirees, claiming that the benefits are merely a replacement for the lost tax exemption and essentially constitute tax rebates to State retirees.

A full understanding of the nature of Plaintiffs' claims requires an historical explanation. Prior to 1989, 21 states exempted recipients of state retirement benefits from income tax while imposing income tax on the benefits of federal retirees. In 1989, the United States Supreme Court ended this practice, finding that it constituted unlawful tax discrimination in violation of federal law and the doctrine of intergovernmental tax immunity. Davis v. Michigan, 489 U.S. 803 (1989).

Utah, like many sister states, responded to the Supreme Court's edict by amending its statute to make state retirement benefits taxable. The legislature also increased pension benefits to state retirees by 3%. Utah Code Ann. § 49-1-701 (1998). It is undisputed that the increase in retirement benefits largely offsets the amount of income tax which an individual Utah retiree would be required to pay.

Plaintiffs contend that Utah's response to the mandate of Davis was nothing more than a sham that merely perpetuated the unlawful discrimination which existed pre-Davis where federal retirees pay full state income tax on their benefits while state retirees pay less than full state income tax on their benefits because of the rebate.

I have reviewed the reported cases addressing similar challenges to legislative responses to Davis. See, Sheehy v. Association of Montana Retired Public Employees, 864 P.2d 786 (Mont. 1993), Ragsdale v. Department of Revenue, 895 P.2d 1348 (Or. 1995), Vogl v. Department of Revenue, 960 P.2d 373 (Or. 1997), Almeter v. Virginia Department of Taxation, 53 Va. Cir. 429 (2000) cert denied, 122 S.Ct. 202 (Mem.) (2001). Irrespective of outcome, these cases recognize that the Davis Court did not foreclose, and in fact anticipated, a state's ability to respond to the Court's holding by increasing benefits to its retirees. Those cases which invalidated, as violative of Davis, increases in state retiree benefits, did so only because the benefit increases incorporated additional provisions which made transparent the true and improper nature of the response--creating a tax rebate.

Specifically, in Sheehy the Montana Supreme Court concluded that Montana's response to Davis was actually a discriminatory partial tax rebate that improperly favored state retirees "living in Montana based solely on the source of their retirement income." Sheehy, 864 P.2d at 768 (1993). Further evidence of a tax rebate was the fact that Montana's funding for the adjustment was statutorily appropriated from the general fund and not funded by investment income produced by the retirement fund itself. Id.

Similarly, in Vogl, it was determined that Oregon's 1995 statutory increase to the Public Employees Retirement System ("PERS") benefits to compensate for "injuries" arising out of the taxation of the PERS benefits was in violation of Davis. Vogl, 960 P.2d 373 (1997). The Vogl court ultimately concluded that the increase in PERS benefits was a tax rebate because the relationship between the lost exemption and the 1995 increase was one of "purported legal equivalence." Id. at 381.

Upon consideration of these cases, I conclude that Utah's statutory response to Davis is untainted by any of the above mentioned provisions from which one could reasonably conclude that the benefit increase was, in fact, a tax rebate.

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and content of the amendments to Utah Code Ann. § 49-1-701 (1998), did not reflect our legislature's desire to accomplish by lawful means the result which the Davis Court found to be impermissibly discriminatory. The timing and intent of the legislature's response to Davis is not, however, controlling. Of primary importance is the plain language of the statutory product of the legislature's response to Davis. The statute itself applies to all members whose retirement allowance was previously exempt from tax, pre-Davis, but whose allowance has "subsequently become subject to the tax." Specifically, a member shall receive:

- (a) the administrator shall calculate the member's retirement allowance pursuant to the formula governing the system from which the member retired;
- (b) the administrator shall then increase the allowance calculated under Subsection (2)(a) by 3%; and
- (c) the adjusted retirement allowance under Subsection (2)(b) is the new basis upon which any future adjustments to benefits are made.

Utah Code Ann. § 49-11-701 (2002)¹.

Additionally, under subsection (6)

- (a) [t]he retirement board shall annually certify the

¹ The 2002 amendment, effective March 27, 2002, renumbered this section, formerly referred to as Section 49-1-701.

contribution rate necessary for each system to comply with this section and may adopt rules to administer this section.

- (b) [t]his contribution rate shall be reported separately from the total contribution rate necessary to fund the systems on an actuarially sound basis and may not be used in comparative studies of public employee benefits.

Utah Code Ann. § 49-11-701 (2002).


A close look at these statutory provisions indicates that the language betrays no discriminatory content. First, the 3% adjustment is given to all retirees who were members of the system. There is no distinction between retirees located in the state of Utah and those located out of state. Essentially, every eligible retiree who retired on or after January 1, 1989, received the 3% increase. Utah Code Ann. § 49-1-701(1)(3) (1998). Second, the statute itself evidences no attempt to coordinate the 3% benefit with the income tax rates or structure as found under Utah Code Ann., Title 59. Finally, distinguishing itself from Sheehy, the plain language shows that the legislature does not fund the 3% adjustment via direct legislative appropriation of tax dollars to eligible retirees. Utah Code Ann. § 49-1-701(6) (1998). Ultimately, the total cost is recognized as a direct part of the total employees' compensation package.

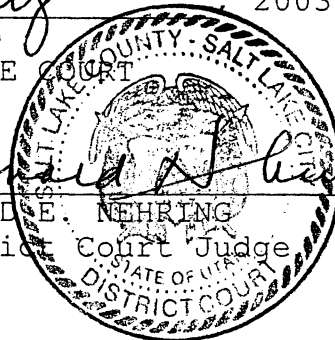
This statutory analysis, coupled with the Davis Court's clear anticipation of the Utah legislature's response, through its holding, warrants the conclusion that Plaintiffs' claims must fail as a matter of law, and Defendants' motion is hereby granted.

In view of the foregoing, I need not reach the other arguments advanced by Defendants in aid of their motion.

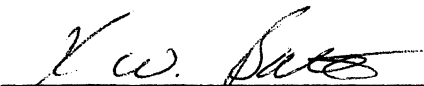
DATED this 13 day of May 2003.

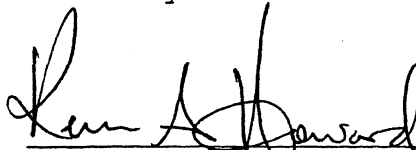
BY THE COURT


RONALD E. NEHRING
District Court Judge



APPROVED AS TO FORM:


Hatch, James & Dodge
Attorneys for Plaintiffs


Howard, Phillips & Andersen
Attorneys for Utah State Retirement
Board

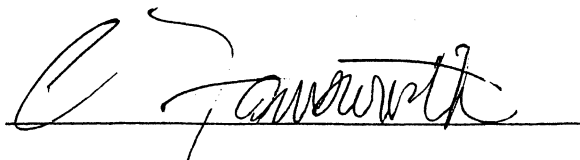
CERTIFICATE OF SERVICE

I hereby certify that on the 13 day of May,
2003, I caused a copy of the foregoing ORDER OF DISMISSAL to be
mailed, postage prepaid, to:

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A handwritten signature in black ink, appearing to read "K. Howard", is written over a horizontal line.

CERTIFICATE OF SERVICE

I hereby certify that on the 7th day of May, 2003, I caused a copy of the foregoing ORDER OF DISMISSAL to be **hand delivered** to:

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